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Supreme Court of the United States.

October Term, 1931.

No. 714.

WALTER J. MacDONALD, Trustee in Bankruptcy of Craig, Reed & Emerson, Inc.,
Petitioner,

v.

PLYMOUTH COUNTY TRUST COMPANY,
Respondent.

On Writ of Certiorari to the Circuit Court of Appeals for the First Circuit.

Brief for Petitioner.

ROBERT A. B. COOK,
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ADDISON C. GETCHELL & SON, LAW PRINTERS, BOSTON.

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OCTOBER TERM, 1931.

No. 714.

WALTER J. MacDONALD, TRUSTEE IN BANKRUPTCY OF CRAIG, REED & EMERSON, INC.,
Petitioner,
v.
PLYMOUTH COUNTY TRUST COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF FOR PETITIONER.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals from which the petition for certiorari was directly prosecuted was rendered November 21, 1931, and appears at 53 F. (2d) 827 (C.C.A. 1) (R. 120-124).

The opinion of the District Judge was rendered January 15, 1931, and appears at 46 F. (2d) 811 (D.C. Mass.) (R. 20-23).

The findings of the Referee in Bankruptcy were made July 29, 1930, and appear at pages 3 to 7 of the record. Upon the findings, according to the printed record, an order

was entered by the Referee on the 29th day of July, 1930 (R. 7). Counsel for both the petitioner and the respondent concur, however, that said date of July 29, 1930, was erroneously printed in the record, and that the true date upon which the order was entered was August 7, 1930. The findings of the Referee and his order are unreported.

Jurisdiction.

The decree of the Circuit Court of Appeals for the First Circuit was entered November 21, 1931. By its decree and in its opinion the said Circuit Court of Appeals ruled that the Referee in Bankruptcy was without jurisdiction, under the Bankruptcy Act, as amended, to hear and determine, in proceedings originating before him, a petition filed by a trustee in bankruptcy for the recovery of property preferentially transferred, even though the respondent had fully consented to the Referee's jurisdiction and had engaged in a trial on the merits before him, and that a decision rendered by the Referee in such proceedings is without binding force upon the respondent.

This decision of the Court is at variance with its own action in the case of *Foster* v. *Manufacturers Finance Company*, 22 F. (2d) 609 (certiorari denied, 276 U.S. 633), and is in direct conflict with the decisions of other Circuit Courts of Appeals—

In re Clarence A. Hopkins (C.C.A. 2), 229 Fed. 378 (certiorari denied, 241 U.S. 669);

American Finance Co. v. *Coppard* (C.C.A. 5), 45 F. (2d) 154;

Board of Education of Salt Lake City v. *Leary* (C.C.A. 8), 236 Fed. 521;

Gamble v. *Daniel* (C.C.A. 8), 39 F. (2d) 447;

Page, Trustee, v. *Arkansas National Gas Corp.* (C.C.A. 8, decided October 5, 1931), 53 F. (2d) 27—

and, moreover, is in conflict with the decisions of this court:

Taubel-Scott v. *Fox,* 264 U.S. 426.
May v. *Henderson,* 268 U.S. 111.
Harrison, Trustee, v. *Chamberlin,* 271 U.S. 191.
Daniel, Trustee, v. *Guaranty Trust Company of New York,* decided March 14, 1932, No. 179 on present docket of U.S. Supreme Court.

The petition for certiorari was granted March 21, 1932.

Statement of Facts.

On or about July 16, 1929, Craig, Reed & Emerson, Inc., for brevity hereinafter referred to as the company, made and executed a general assignment for the benefit of its creditors unto one Loring H. Hall, an officer of the Plymouth County Trust Company, which company for brevity is hereinafter referred to as the respondent (R. 24).

The company had for a number of years prior to its assignment operated and conducted a wholesale shoe business in the city of Brockton. The company's products were sold chiefly to retail chain shoestores. In 1926 the company lost its biggest customer, and from that time onward its operations were conducted at a substantial loss (R. 63). This fact was known to the respondent and its president at the times of the transactions herein complained of (R. 95). The company had been indebted for a period of years to the respondent (R. 93). This indebtedness was represented by negotiable time notes, which, because of the company's inability to pay, were renewed from time to time as they matured (R. 93). But on March 8, 1927, the respondent, regarding the said indebtedness so due it as a frozen loan (R. pp. 73, 93) and knowing that the company was losing money, refused to renew further the loan on time, but insisted upon and received a demand note in the sum of $36,500, which amount was then due it by the company (R. 93). From

March 8, 1927, down to July 12, 1929, a matter of twenty-eight months, no payment was made by the company to the respondent on account of the principal of this loan (R. 72). The president of the respondent knew that it was futile even to ask for payment. He knew the loan could not be paid without wiping out the business. He knew that to insist upon payment meant closing down the business (R. 94, 97, 98, 109), and he also knew that the company was insolvent (R. 97); and so the loan was permitted to run for more than two and a quarter years without any payment whatsoever on the principal.

In June, 1929, and fully three weeks before the time when the company made and executed its assignment for the benefit of creditors, a meeting of the stockholders of the company was held (R. 15). The only person present at the meeting who was not a stockholder or a representative of a stockholder was the president of the respondent. The purpose of the meeting was to determine whether the business should be operated for the few months next succeeding, and, if so, how it could be done with the least possible loss (R. 63).

The president of the respondent testified in these proceedings that he did not agree to an extension until the following October (R. 99). His testimony, however, is at conflict with that of one of the officers of the company (R. 59). At any rate, however, this president did not openly dissent, nor did he so conduct himself at such meeting that those present knew he was not assenting. *All moneys thereafter appropriated or set off by the respondent were deposited by the company subsequent to the time of this meeting.*

The company at that time (June, 1929), and for some while previous thereto, manufactured chiefly for one customer. This customer paid its bills around the middle of each month, a fact which was known to the respondent and certain of its officers (R. 77, 91).

On or about July 10, 1929, the vice-president of the respondent instructed one of his assistants to make a notation on

the ledger card, upon which was kept the company's account, to the effect that all checks on the account and all deposits therein made should be shown to him, the vice-president (R. 69); and, in pursuance of these directions, the assistant so instructed did so call the deposit slips to the attention of that vice-president (R. 69).

The officers of the respondent consulted its counsel on July 12 respecting its right of appropriation or set-off, and, as a part of the advice which it then received, it was told that wage claims had priority in liquidation, consequently [illegible] any wage checks outstanding (R. 109). A [illegible] wage checks, amounting to a negligible total, [illegible] by the respondent, but between July 12, when the first appropriation was made, and July 15, the date of the last appropriation, no other checks of the company were paid by it. Between such dates checks which the company had given to various merchandise creditors were presented, but no official action was taken thereon until after the appropriation of July 13, when all the checks then in possession of the respondent were returned dishonored (R. 45, 46). The respondent refused payment of and returned checks aggregating $6170.94 drawn by the company around July 12 and 13 (R. 102).

Late on the afternoon of July 11, 1929, the company made a deposit with the Campello branch of the respondent in the sum of $15,100.78 (Exhibit 5, R. 112 a). The respondent then acted. At that time it was holding to the credit of the company *collected* funds of $4027.29. This amount was appropriated or set off on July 12, 1929 (Ex. 6, R. 112 b). The *uncollected* funds, including the deposit so made on July 11, 1929, were not immediately appropriated, and for two reasons: (1) If credit were given for uncollected funds, and later the same should for any reason prove uncollectible, the bank "would be out of luck" (R. 76); and (2), as the company customarily paid its help by checks, there were usually wage checks outstanding, and, as these checks would

have priority in liquidation, they therefore should be paid (R. 80). After paying a few of these wage checks, however, the respondent refused to pay more, but turned over such wage checks to the assignee, who made payment thereof out of funds coming to him as such assignee (R. 88).

It was the practice of the respondent at the time of this deposit on July 11, 1929, to send its check deposits through to its correspondent banks for collection by ordinary mail and with a communication, commonly referred to as a transit letter, usually prepared for the respondent by one of its clerks. In this instance, however, the checks comprising the deposit of July 11, 1929, were sent to the correspondent bank in New York with a special letter, by special delivery, dictated by an officer of the respondent, expressing the request that the correspondent notify the respondent immediately by wire whether the said checks were paid upon presentation (R. 37). The respondent had not then notified the company of what it was doing, and what it was contemplating doing (R. 38). Failing to get an answer as early on the 13th of July as was desired, an officer of the respondent telegraphed to its correspondent in New York (R. 40), and, still failing to get an answer as desired, a third communication in the form of a letter was sent, criticizing the correspondent for the delay (R. 40). Later, however, advises were received to the effect that the checks had been paid, and thereupon and on said 13th day of July, 1929, the deposit of $15,100.78 was appropriated. *At no time did this deposit ever appear on the respondent's books as a part of the company's balance with it* (Ex. 6, R. 112 b). Even on July 13, 1929, the company had not been apprised of what the respondent was doing (R. 55). Later that day, however, a letter was addressed by an officer of the respondent to the company, sent by registered mail, and delivered to the company the following Wednesday, July 17, 1929, wherein the respondent advised the company that its loan

had been called. Nothing, however, was then said about the appropriations or set-offs that had been made.

On Monday, July 15, 1929, and two days before the receipt by the company of the registered letter sent it, the vice-president of the respondent called one of the officers of the company by telephone, told him that the loan had been called, and that the respondent had determined that his company was to make an assignment for the benefit of its creditors (R. 55, 56). This was the first knowledge communicated in any way to the company of the plans which the respondent and its officers and counsel had caused to be made in connection with the company's affairs. The officer of the company to whom this communication was delivered stated that he would call at the bank and talk matters over, but would sign no papers, in the absence of his business associate, also an officer of the company, who was then away on a selling trip. The latter, however, was reached by telephone, and the following day, Tuesday, July 16, the two officers of the company, Craig and Reed, repaired to the bank and then and there endeavored to prevail upon the officers of the bank to undo what they had done and to permit the company to go on in business (R. 100). This request was refused and the assignment for the benefit of creditors was executed that afternoon and recorded the next day, the 17th. A sale of the assets of the company was thereafter made by the assignee, and within a day or two following the time of such sale, and on the 28th day of September, 1929, a creditors' petition in bankruptcy was filed, and upon this petition the company was duly adjudicated bankrupt and the petitioner herein was elected trustee. The officer of the respondent who was serving in the capacity of assignee surrendered and delivered to the petitioner the funds in his possession derived from the sale of the company's assets, but he and his principal, the respondent, refused to surrender and deliver unto the petitioner as trustee the funds that the respondent had appropriated and amounting in the

aggregate to $20,476.79 and comprising appropriations made on July 12th, 13th and 15th. Upon such refusal, the petitioner filed a bill in equity with the Referee in Bankruptcy, having charge of the administration of the company's affairs, to recover from the respondent the funds so preferentially received by it. The respondent formally consented to the jurisdiction of the Referee, and the cause was thereupon heard at length on the merits before such Referee. The Referee made a finding against the respondent, who thereupon took a review to the District Judge.

At the hearing before the latter, and for the first time and notwithstanding its formal consent and its engaging in a hearing on the merits before the Referee, the respondent questioned the jurisdiction of the Referee. The District Judge overruled this contention of the respondent, and, after arguments on both the facts and the law, and after consideration thereof, entered a decree in favor of the petitioner herein. From this decree an appeal was taken to the Circuit Court of Appeals for the First Circuit, and that court, without in any wise passing upon the merits, held in substance that, irrespective of the respondent's formal consent and irrespective of its going to trial on the merits before the Referee and its peculiar relation to the assets of the estate, the Referee was without jurisdiction to hear the suit, and that jurisdiction could not be conferred upon him.

Schedule of Important Dates.

March 8, 1927, the respondent refused to renew on time the then maturing loan of Craig, Reed & Emerson, Inc., and insisted and received a renewal note payable on demand. The respondent through its officers regarded the loan as a "frozen" one, and also regarded the company as "insolvent."

June, 1929, an informal meeting of the stockholders of Craig, Reed & Emerson, Inc., was held for the purpose of

determining whether the business could be carried along for another three months, and, if so, how it could be conducted at the least possible loss. The only person present at the meeting other than stockholders, or representatives of stockholders, was the president of the respondent company (day and date of meeting not determined, but according to testimony such meeting occurred about three weeks before the assignment for creditors).

July 10, 1929, the respondent caused a notation to be made on the ledger card upon which the account of Craig, Reed & Emerson, Inc., was kept: "show all checks & deposits to Mr. Crocker" (respondent's vice-president).

July 11, 1929, Craig, Reed & Emerson, Inc., deposited with the respondent four checks drawn on a New York bank or banks aggregating $15,100.78.

July 12, 1929, the respondent transmitted said checks with a special letter to National City Bank, requesting the latter to "collect the same, placing credit to our account and advising us immediately by wire."

July 12, 1929, the respondent appropriated without notice at the time to the company all collected funds, amounting to $4027.29, then standing to the credit of the company with the respondent. The respondent consulted counsel with respect to appropriations, and the respondent, without notice to the company, directed that an assignment for the benefit of creditors be drawn for the company's execution, the assignee being an officer of the respondent.

July 13, 1929, telegram by respondent to National City Bank, inquiring fate of checks aggregating "fifteen thousand odd."

July 13, 1929, letter from respondent to National City Bank supplementing telegram.

July 13, 1929, letter from respondent to Craig, Reed & Emerson, Inc., advising it that respondent was "calling this note for payment as of this date, Saturday, July 13." This

letter was sent by registered mail and was not delivered until July 17.

July 15, 1929; on the morning of this day the respondent by its vice-president called one of the officers of Craig, Reed & Emerson, Inc., and informed him that the bank had called its loan and that the officers of Craig, Reed & Emerson, Inc., should come up to the bank at once and execute the assignment for creditors that had been drawn.

July 16, 1929, Craig, Reed & Emerson, Inc., assigned for the benefit of its creditors to Loring H. Hall, an officer of the respondent company.

July 17, 1929, the assignment for the benefit of creditors was duly recorded.

September 27, 1929, the assignee sold and disposed of all assets to one Hogan, acting as agent for Craig, Reed and other stockholders.

September 28, 1929, an involuntary petition in bankruptcy was filed in the District Court of the United States for the District of Massachusetts by certain creditors for the adjudication of Craig, Reed & Emerson, Inc., as a bankrupt.

October 14, 1929, adjudication made.

November 27, 1929, Walter J. MacDonald of Brockton appointed trustee.

April 14, 1930, trustee's amended bill of complaint filed with the Referee in Bankruptcy, after counsel for the proposed defendant had consented to Referee's jurisdiction.

April 30, 1930, hearing before the Referee on merits.

August 7, 1930, Referee's order.

August 11, 1930, the respondent filed its petition for a review of Referee's order.

August 15, 1930, the trustee filed his petition for a review of Referee's order.

November 5, 1930, certificate of the Referee recommitted by order of District Judge.

November 20, 1930, Referee filed amended certificate.

January 15, 1931, opinion and decree of District Judge awarding judgment in favor of the petitioner in the sum of $20,476.79, with interest from December 5, 1929.

January 29, 1931, respondent filed its appeal petition along with assignment of errors, which appeal was promptly allowed.

October 13, 1931, hearing before Circuit Court of Appeals for the First Circuit.

November 21, 1931, opinion and decree of Circuit Court of Appeals.

February 19, 1932, trustee's petition for a writ of certiorari filed with the United States Supreme Court.

March 21, 1932, certiorari granted.

Specification of Errors.

The petitioner claims that the Circuit Court of Appeals for the First Circuit erred—

1. In holding that the Referee in Bankruptcy was without jurisdiction in the instant case.

2. In failing or refusing to adjudicate the issues on their merits.

Questions Presented.

1. Did the parties by their consent, expressed in open court, and by proceeding to trial upon the merits, confer jurisdiction upon the court below to hear and determine the issues involved?

2. Were the several appropriations made by the respondent on July 12, 13 and 15, 1929, preferential transfers within the purview of the Bankruptcy Act as amended?

a. Was the company insolvent when and at the times of the appropriations or set-offs complained of?

b. Did the respondent at such times of appropriations or set-offs have reasonable cause to believe that preferences would be effected thereby?

c. Were the funds on deposit with the respondent on July 12, 1929, received in such manner as to enable it lawfully to apply such funds by way of appropriations or set-offs against indebtedness due it by the company?

d. Were the deposits of July 11, 1929, and July 15, 1929, respectively, made and received in the usual course of dealings between the parties and in such manner as to enable the respondent lawfully to appropriate such deposits and to set them off against indebtedness then due and owing it by the company?

Statutes Involved.

Bankruptcy Act of 1898 as amended:

Section 1. (7) "'court' shall mean the court of bankruptcy in which the proceedings are pending, and may include the referee."

Section 1. (8) "'courts of bankruptcy' shall include the district courts of the United States and of the Territories and possessions to which this Act is or may hereafter be applicable, the supreme court of the District of Columbia, and the United States court of Alaska."

Section 23. (b) "Suits by the trustee shall be brought or prosecuted only in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought or prosecuted them if proceedings in bankruptcy had not been instituted, unless by consent of the proposed defendant, except suits for the recovery of property under section sixty, subdivision b; section sixty-seven, subdivision e; and section seventy, subdivision e."

Section 38. (a) (4) "Referees respectively are hereby invested, subject always to a review by the judge within the limits of their districts as established from time to time, with jurisdiction to perform such part of the duties, except as to questions arising out of the applications of bankrupts for composition or discharges, as are by this act conferred on courts of bankruptcy and as shall be prescribed by rules or

orders of the courts of bankruptcy of their respective districts, except as herein otherwise provided."

Section 60. (b) "If a bankrupt shall have procured or suffered a judgment to be entered against him in favor of any person or have made a transfer of any of his property, and if, at the time of the transfer, or of the entry of the judgment, or of the recording or registering of the transfer if by law recording or registering thereof is required, and being within four months before the filing of the petition in bankruptcy or after the filing thereof and before the adjudication, the bankrupt be insolvent and the judgment or transfer then operate as a preference, and the person receiving it or to be benefited thereby, or his agent acting therein, shall then have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference, it shall be voidable by the trustee and he may recover the property or its value from such person. And for the purpose of such recovery any court of bankruptcy, as hereinbefore defined, and any state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

Summary of Argument.

The petitioner's bill in equity was in the form of a plenary suit. The trial thereupon proceeded according to the rules of evidence obtaining in a plenary action. The consent given by the respondent was sufficiently adequate and complete to enable the Referee to hear and determine the issues. The respondent was in no wise harmed by proceeding as it did. See—

Taubel-Scott v. *Fox*, 264 U.S. 426, 433, 434.

See also—

May v. *Henderson*, 268 U.S. 111.
Harrison, Trustee, v. *Chamberlin*, 271 U.S. 191.

Daniel, Trustee, v. *Guaranty Trust Company of New York,* decided March 14, 1932, No. 179 on present docket of U.S. Supreme Court.

As this litigation has already covered a considerable period of time, and as counsel have united in presenting to this court all questions that arise upon the record, it is desirable that this court completely decide all issues, even though the Circuit Court of Appeals for the First Circuit apparently did not consider the merits.

Cole v. *Ralph,* 252 U.S. 286, 289, 290.

Upon the facts it definitely appears that the company was insolvent; that the respondent not only had reasonable cause to believe it insolvent, but actually knew of the company's insolvency, and knew or had reasonable cause to believe that the moneys it was appropriating would prefer it over other creditors of a like class. It was the respondent, and not the company, who first determined that the company should make and execute an assignment for the benefit of creditors, thereby committing an act of bankruptcy. The respondent knew that the company could not continue in business after the respondent had made the appropriations of its bank deposits and balance as the respondent contemplated doing.

The respondent has at no time questioned the right of the Referee to exercise summary jurisdiction in compelling one of its officers, who was the assignee for the benefit of creditors, to turn over the property which had been assigned to him; and it expressly consented to the Referee's exercising the power to hear and determine the trustee's bill for the recovery of the moneys so appropriated by the respondent.

Hence the petitioner submits that he is entitled to recover in these proceedings.

ARGUMENT.

I.

Did the parties by their consent, expressed in open court, and by proceeding to trial upon the merits, confer jurisdiction upon the court below to hear and determine the issues involved?

It will be well first to consider the organic law. Under the caption "Jurisdiction of United States and State Courts," section 23 (b) of the Bankruptcy Act, as it was originally enacted, provided as follows: "Suits by the trustee shall be brought or prosecuted only in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought or prosecuted them if proceedings in bankruptcy had not been instituted, unless by consent of the proposed defendant." And thereafter, in 1903, and again in 1910, Congress enacted certain amendments to the law for the purpose of giving greater definiteness to various of its provisions and for the enlargement of the scope of the law. To section 23 (b) were added the following words: "except suits for the recovery of property under Section 60, subdivision b; section sixty-seven, subdivision e; and section seventy, subdivision e." And to section 60 (b), under the caption "Preferred Creditors," and having to do with the recovery of property preferentially transferred, there was added by way of amendment the following: "And for the purpose of such recovery any court of bankruptcy, as hereinbefore defined, and any state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction." There have been no material changes since made in these sections.

When we pause and consider these amendments, it becomes convincingly clear that it was the intention of Congress that courts having to do with the administration of bankruptcy cases should, so far as might be practicable, be vested with jurisdiction over all matters arising in such

cases. Prior to the amendments of 1903 and 1910 there was but one class of cases which a trustee in bankruptcy could, as a matter of right under section 23 (b), institute in courts administering bankruptcy; and, with these amendments, another class was added. But at all times, both before 1903 and since, such courts have always, and with the consent of the proposed defendant, had jurisdiction over all matters and controversies arising in bankruptcy.

Jurisdiction by consent is in no wise limited or restricted by the amendment of 1903 made to section 60 (b). That amendment was merely to conform with the amendment to section 23 (b), which latter section was being enlarged in its scope and operation. Congress did not by these amendments disturb the consent provision of section 23 (b).

The right of the Referee to hear a petition such as was filed in the instant case was decided by this court in the case of *Taubel-Scott* v. *Fox*, 264 U.S. 426. At page 431 the court said:

> "But Congress did not, either by § 2, § 23 of the Bankruptcy Act of 1898 or any other provision of the act, confer generally such broad jurisdiction over claims by a trustee against third persons. Nor has it provided, in terms, that a substantial adverse claim to property which is not in the possession of the bankruptcy court and which is demanded by the trustee under subdivision f of § 67, may be litigated, without consent, by a summary proceeding."

And again, at pages 433, 434:

> "Wherever the bankruptcy court had possession it could, under the Act of 1898, as originally enacted, and can now, determine in a summary proceeding controversies involving substantial adverse claims of title under subdivision e of § 67, under subdivision b of § 60 and under subdivision e of § 70. But in no case where it

lacked possession, could the bankruptcy court, under the law as originally enacted, nor can it now (without consent) adjudicate in a summary proceeding the validity of a substantial adverse claim. In the absence of possession, there was under the Bankruptcy Act of 1898, as originally passed, no jurisdiction, without consent, to adjudicate the controversy even by a plenary suit. The Act of February 5, 1903, c. 487, § 8, 32 Stat. 797, 798, 800, together with the Act of June 25, 1910 c. 412, § 7, 36 Stat. 838, 840, conferred upon the bankruptcy court jurisdiction, under certain circumstances, against the adverse claimant, in a plenary suit under § 60, subdivision b, § 67, subdivision e, and § 70, subdivision e."

And prior to the foregoing decision, this court, speaking through Mr. Chief Justice Fuller in the case of *Mueller* v. *Nugent,* 184 U.S. 1, at page 13, said:

"We think the referee has the power to act in the first instance in matters such as this, when the case has been referred, and in aid of the court of bankruptcy, and exercises in such cases 'much of the judicial authority of that court'. *White* v. *Schloerb,* 178 U.S. 542. By petition for review the matter can be carried to the bankruptcy court and the entire record and findings laid before that tribunal as was done here."

The facts in that case were substantially these: Following an adjudication and a reference to the Referee in Bankruptcy, the latter, upon a summary petition filed before him, entered an order requiring Nugent, an agent of the bankrupt, to show cause why he should not surrender up and deliver unto the trustee certain property which he, the said agent, was then holding. The real question in the case, said the court, in substance, was whether the Referee's order directing the surrender of the property was lawful,

and that in turn raised the question of the validity of the show cause order.

At page 14:

> "Has the bankruptcy court the power to compel the bankrupt, or his agent, to deliver up money or other assets of the bankrupt, in his possession or that of some one for him, on petition and rule to show cause? . . .
>
> "The bankruptcy court would be helpless indeed if the bare refusal to turn over could conclusively operate to drive the trustee to an action to recover as for an indebtedness", etc.

It will be observed that in the case of *Mueller* v. *Nugent* this court very definitely refers to the Referee, not once, but several times, as the "bankruptcy court," and according to the law he is, in given circumstances, the Bankruptcy Court. See sections 1 (7), 1 (8) and 38 (4), all hereinbefore quoted at length. The term "court" as defined in section 1 (7) is more comprehensive than the term "court of bankruptcy" as defined in section 1 (8).

To like effect see—

Taubel-Scott v. *Fox*, 264 U.S. 426.
May v. *Henderson*, 268 U.S. 111.
Harrison, Trustee, v. *Chamberlin*, 271 U.S. 191.

The decision of the Circuit Court of Appeals of the First Circuit in the instant case is utterly in conflict with the disposition made by it of the case of *Foster* v. *Manufacturers' Finance Company*, 22 F. (2d) 609 (certiorari denied, 276 U.S. 633), wherein a petition for the recovery of a preferential transfer was filed with and heard by Mr. Referee Young with the consent of both parties. It was the Referee who raised the jurisdictional question and disposed of it in these words:

> "Admitting the Manufacturers' Finance Company

to be an adverse claimant not within the summary jurisdiction of the court under ordinary circumstances, it is clear that in this particular case that company has consented to the jurisdiction. Harrison, Trustee, v. Chamberlin, 271 U. S. 191."

This case was later heard before one of our District Judges, and still later was heard and decided by the Circuit Court of Appeals, from whose decision certiorari was sought and denied by this court. Obviously the Referee's conclusion of law was accepted, for, notwithstanding the fact that the record clearly disclosed that the parties were before the court seeking summary jurisdiction against an adverse claimant who had consented thereto, nevertheless neither the District Court nor the Circuit Court of Appeals questioned its jurisdictional right to hear and determine the cause.

By other Circuit Courts of Appeals we have the following decisions in support of our contention:

In re Hopkins (C.C.A. 2), 229 Fed. 378, at page 380:

"The question was presented to the Trustee whether he would proceed summarily or by plenary suit and he elected the former without objection by the bankrupt, his wife or any one else. Having proceeded without objection, we think it is too late now to present a question which is addressed solely to the form of the proceeding. If the objection had been made at the time the Trustee was required to elect, it is quite possible that the petitioner's contention would have been sustained. But she, apparently, acquiesced in the summary proceedings as the most satisfactory way of disposing of the question and we are of the opinion that it is too late to present the question on this review by an Appellate Court."

American Finance Co. v. *Coppard* (C.C.A. 5), 45 F. (2d) 154, at page 155:

> "if the [adverse] claim is found to be real and substantial, the court must decline to determine the merits and dismiss the summary proceeding, unless the adverse claimant has consented to the proceeding."

Whitney v. *Barrett* (C.C.A. 5), 28 F. (2d) 760, at page 761:

> "This was a summary proceeding. In such a proceeding the bankruptcy court is without jurisdiction to determine a controversy in reference to property adversely held without the consent of the adverse claimant."

Board of Education of Salt Lake City v. *Leary* (C.C.A. 8), 236 Fed. 521, there held that the court could proceed summarily to adjudicate the matter only by consent.

In the case of *Gamble* v. *Daniel* (C.C.A. 8, 1930), 39 F. (2d) 447, occur one of the latest pronouncements on the subject. At page 453:

> "If such possession be in the bankrupt the court of bankruptcy has jurisdiction by summary proceedings to adjudicate the rights of the parties; while, if such possession is elsewhere, the adjudication must be by plenary suit in the proper federal or state court, if the claimant objects to a summary proceeding in the bankruptcy court. This rule has been so often announced that it is necessary to cite only the latest cases."

See cases there cited.

Another comparatively recent case is that of *In re White Satin Mills* (D.C. Minn.), 25 F. (2d) 313, at page 314:

> "It is well settled that a court of bankruptcy is without jurisdiction to adjudicate in a summary proceeding

a controversy in reference to property held adversely to the bankrupt estate without the consent of the adverse claimant."

This case cites *In re Friedman Bros.*, 19 F. (2d) 243, 244.

There is not a single reported case that we have been able to find which, under the bankruptcy law as now amended, fails to hold that adequate jurisdiction over an adverse claimant is not acquired if he consents thereto.

The principles hereinbefore enunciated are not to be confused with the premise that a trustee can implead before a Referee in Bankrutpcy an adverse claimant without his consent. This latter premise is obviously unsound. See—

Weidhorn v. *Levy*, 253 U.S. 268:

There a suit was brought, plenary in character, before a Referee in Bankruptcy for the purpose of setting aside a transfer of property as provided in section 70 (e). The respondent in the suit never consented to jurisdiction, nor had he in any wise invested jurisdiction in the court, but at all times objected to the latter's exercising jurisdiction over the case. In line with its earlier decisions, this court there held that the trustee in bankruptcy could not, without the consent of the adverse claimant, implead him before a Referee in Bankruptcy.

There are many authoritative cases holding to like effect that substantial adverse claimants cannot, upon petition and without consent, be impleaded in a summary proceeding, but these cases are not here in point.

It will also be borne in mind that in the instant case the respondent not only appropriated the bankrupt's balance and certain deposits as previously stated, but, moreover, and immediately thereafter, obliged the bankrupt company to assign all its property to an officer of the respondent herein. As to the property so assigned, neither the respondent nor its officers or the assignee raised any question

whatsoever about the summary jurisdiction of the court, but surrendered all such property or the proceeds thereof to the court. As to the bankrupt's balance and deposits that had been appropriated by it, the respondent set up claims of adverse ownership. As will be seen from the authorities hereinbefore cited, it was well within the power of the Referee to determine whether the respondent's claims were merely colorable in character, or, on the other hand, were made in good faith and were substantial. If they were merely colorable, the Referee was well empowered to act.

Mueller v. *Nugent, supra.*

II.

Were the several appropriations made by the respondent on July 12, 13 and 15, 1929, preferential transfers within the purview of the Bankruptcy Act as amended?

Before proceeding with our argument upon the facts, it is well to observe that counsel are united in presenting to this court all questions arising upon the record, and as this litigation already has covered a considerable period of time, it is desirable that this court proceed with a complete decision of the case. See—

Cole v. *Ralph,* 252 U.S. 286, 289, 290.

A. Was the company insolvent when and at the times of the appropriations or set-offs complained of?

Hall, who was the assignee under the assignment for the benefit of creditors and an officer of the respondent, testified that the assets of the above company had been sold by him for $14,330.01, which amount represented the fair value of all the assets of the company both as of the time of the assignment and of the time of the sale, and also as of the times of the said set-offs or appropriations, which were

within four days of the assignment; and that the liabilities of the said company at such times were $58,016.36.

The president of the respondent testified that he regarded the company as insolvent (R. 97) as of said times; hence, upon the admission of the respondent, the company was insolvent as of the times complained of.

B. Did the respondent at such times of appropriations or set-offs have reasonable cause to believe that preferences would be effected thereby?

There can be no controverted issue under this question, for the respondent, by one or more of its officers, who had charge of the transactions between it and the company, had knowledge of the insolvency of the company as of the times complained of and therefore not only had reasonable cause to believe, but actually had knowledge, that the appropriations or set-offs made by it would operate to give it a larger percentage of its indebtedness than would be received by other creditors of the company of the same class.

The president of the respondent testified before the Referee that he knew that it was futile even to ask the company for payment—he knew that the loan could not be paid without wiping out the business. He knew that to insist upon payment meant closing down the business (R. pp. 94, 98), and he also knew that the company was insolvent. Substantially the same knowledge was possessed by Crocker, the vice-president. He knew the loan was a "frozen" one and could not be collected. Consequently, and in the light of the knowledge possessed by it, the respondent not only had reasonable cause to believe that the appropriations or set-offs made by it would operate to give it a larger percentage of its indebtedness than would be received by other creditors of the same class, but actually knew that such would be the result. The outstanding authority governing this principle of law is the case of *Merrimack Nat. Bank* v. *Hollis R. Bailey et al.*, decided by the Circuit Court of Ap-

peals for the First Circuit and reported in 289 Fed. 468 (certiorari denied, 263 U.S. 704).

C. Were the funds on deposit with the respondent on July 12, 1929, received in such manner as to enable it lawfully to apply such funds by way of appropriations or set-offs against indebtedness due it by the company?

> "Bank creditors are subject to exactly the same rule of law as to preferences and set-offs as are merchandise and other creditors."
>
> *Merrimack Nat. Bank* v. *Hollis R. Bailey et al.* (C.C.A. 1), 289 Fed. 468, 470.

The collected funds of $4027.29 represented deposits made with the respondent by the company subsequent to the time of a certain stockholders' meeting held some three weeks prior to July 12, 1929, the date of the first appropriation or set-off.

The president of the respondent was the only creditor or representative of a creditor at that meeting. He was there asked to grant an extension of time for the payment of the indebtedness due to the bank. While it is true that the president in his testimony states that he did not agree to grant the extension, yet by his words and conduct at such meeting he led some of those present to believe that, in behalf of the respondent, he was assenting to the request. Had he not so conducted himself, it stands to reason that the funds of the company would not have been imperiled by further deposits in that bank. Besides, the president's course of conduct at such time in so falsely misleading the stockholders was quite in keeping with the course thereafter pursued by him and the respondent.

They knew that the company's principal customer paid its bills to the company around the middle of each month. On or about the 10th of the month following the stockholders'

meeting, a notation was caused to be made on the ledger card, upon which was kept the company's account, directing that all deposits and checks drawn on the account should be shown to the vice-president. The respondent and its officers did not then reveal to the company and its officers its intentions and actions.

Later, and on July 12, when the respondent had in its hands the expected funds, it promptly caused a set-off to be made of all the collected funds then in the account. Even then the company and its officers were kept in ignorance of the respondent's actions.

The first knowledge the company had of what the bank had done came on Monday, July 15, 1929.

Upon the facts it is evident that the deposits made from and after the time of the stockholders' meeting were not received by the respondent in the regular and usual course of dealings between it and the company.

The facts in the Bailey case are quite analogous to those here presented, save that in the former case a creditors' committee had been appointed, which fact was known to the bank, whereas in the instant case a meeting of stockholders had been called and held, and what transpired at that meeting was known to the bank.

The Bailey case is authority for most of the petitioner's contentions. It establishes that a transfer and a set-off are one and the same, and are to be dealt with accordingly; that bank creditors are to be treated according to the same rule as are merchandise and other creditors; that a bank having knowledge of insolvency is affected by the same rule as is any other creditor, and that after such knowledge there can be no "usual course of business."

At page 471 Mr. Justice Anderson, speaking for the court, said:

> ". . . if then the banks had had and had exercised the right of set-off claimed by the present appellant,

substantially all of the assets would have been appropriated by the bank creditors, leaving nothing for the general merchandise creditors. A result more obnoxious to the principle of equality, which underlies the Bankruptcy Act, can hardly be imagined."

It is interesting to observe that in the instant case the bank did appropriate $20,476.79, leaving assets worth about $14,000 to be shared *pro rata* by the bank, upon the balance of its claim, with all other creditors—a result exceedingly "obnoxious to the principle of equality."

A State authority also in point is the case of *Putnam* v. *United States Trust Co.*, 223 Mass. 199, opinion by Mr. Chief Justice Rugg. This case holds, briefly, that a bank cannot set off deposits from and after acquiring knowledge of insolvency without creating a preference, and that there is no distinction between a payment and a set-off. This authority, like many others, distinguishes the Massey and Studley cases, hereinafter referred to, and clearly shows that those cases have no application to any phase of law here involved.

Upon the facts and the law, the petitioner respectfully submits that the respondent did not have the lawful right on July 12, 1929, to set off the sum of $4027.29, and hence the same is recoverable by the petitioner in this proceeding with interest.

D. Were the deposits of July 11, 1929, and July 15, 1929, respectively, made and received in the usual course of dealings between the parties and in such manner as to enable the respondent lawfully to appropriate such deposits and to set them off against indebtedness then due and owing it by the company?

Deposits received by a bank after it has knowledge of the insolvency of the depositor, and with the intention of applying the same on account of the indebtedness due by such depositor to the bank, cannot lawfully be appropriated or

set off, for that the same are not received in the ordinary and usual course of dealings between the parties; and any attempt on the part of the bank so to do constitutes an unlawful preference.

See *Mechanics' Bank* v. *Ernst*, 231 U.S. 60.
National City Bank v. *Hotchkiss*, 231 U.S. 50.
May v. *Henderson*, 268 U.S. 111.
Continental Nat. Bank v. *Moore* (C.C.A. 9), 299 Fed. 270 (certiorari denied, 266 U.S. 612).
First Nat. Bank of El Centro v. *Harper* (C.C.A. 9), 254 Fed. 641.
Bank of Commerce and Trust Co. v. *Hatcher* (C.C.A. 4), 50 F. (2d) 719.
Gates v. *First Nat. Bank of Richmond*, 2 A.B.R. (N.S.) 507 (D.C.).
Re Fairburn Oil & Fertilizer Co., 240 Fed. 835
Merrimack Nat. Bank v. *Bailey*, *supra*.
Putnam v. *United States Trust Co.*, *supra*.

The Hotchkiss and Ernst cases (opinions by Mr. Justice Holmes) are of peculiar interest:

In the Hotchkiss case, at page 58:

> "The bank did not confine its demand to proceeds of the loan, but asked for and obtained securities without regard to their source. It was notified in terms that it was receiving a preference and that the firm was going into bankruptcy. If this was not sufficient notice, it is hard to imagine what would be enough."

In the instant case the respondent did the planning for the liquidation, as well as the notifying.

In the Ernst case, at page 67:

> "The so-called deposit of $54,048.08 was paid in after the cashier had forbidden the payment of checks against

the deposit account, and therefore rightly was held to be a payment and a preference. A set-off properly was denied."

Here again the facts are somewhat analogous. Under the directions of the vice-president, no checks were paid, except a few small wage checks, and these were paid solely because counsel had said that they would have priority in the liquidation of the bankrupt's affairs. Even all checks of this character, which were presented, were not paid, for most of them were held up and subsequently turned over to the assignee for payment by him out of the funds coming into his possession.

The characterization of the deposits as "the so-called deposit" is particularly applicable to the facts in the case at bar, for, in truth, the moneys which the respondent bank received on July 11 and on July 15 did not assume the aspects of *bona fide* deposits, due to the then intentions of the respondent and its officers.

The case of *Continental National Bank* v. *Moore, supra,* did not turn on any point involved in the instant case, yet the reasoning there employed clearly recognizes that, under facts such as here presented, a preference is created.

In the *First National Bank of El Centro* v. *Harper* the petitioner has an outstanding authority in support of his contentions. After distinguishing the facts there, which were analogous to the facts in the case at bar, from the Massey and Studley cases, hereinafter referred to, it held, in substance (p. 86): "That the monies so collected by the bank were deposits created otherwise than in the ordinary relation between a bank and its depositor." There was no fraud or collusion between the bank and its depositor. This case, therefore, clearly stresses the point that fraud or collusion between depositor and bank is not essential to defeat the right of set-off.

The case of *Bank of Commerce and Trust Company* v. *Hatcher, supra,* was decided but a short while ago. There the bankrupt for whom Hatcher was trustee had for some while been insolvent and such insolvency was known to the bank. The bankrupt company had undertaken the completion of a road contract which had been started by another. One of the conditions under which the contract was sublet to the bankrupt company by the original contractor was that the moneys received from the contract should be deposited with the appellant bank and that the sub-contractor, the bankrupt, should disburse such funds by checks bearing the signature of the bank's vice-president. At that time the bankrupt was owing the appellant bank a substantial sum of money. Its promises of payment had failed to materialize. On December 2 the bankrupt had no balance to its credit with the appellant. Later on that day, however, the bankrupt's bookkeeper deposited to his company's credit the sum of approximately $8000, received from this road contract, and at the same time submitted to the vice-president of the bank checks in like amount drawn to creditors. The vice-president refused to approve these creditor checks, but did receive the deposit and applied the same on account of the bank's claim. The question involved was, Whether the deposit was received in the usual course of business? Held, that it was not a deposit received in the usual course of business, but rather was a recoverable preference.

In the Gates case (D.C. Va.) the District Judge, delivering his opinion from the bench, at page 511, said:

> "I asked him, myself, that question,—if the company were forced into bankruptcy would it be in a position to deny bankruptcy, by asserting solvency, and he said clearly he had no such idea, that the only way to save it was to keep out of bankruptcy, by the methods suggested."

Again, at page 513:

> "The company was not, it is true, being operated by its creditors' committee, therefore the deposits in the bank were made by the company itself, rather than as in the Merrimac case. But the deposits were after the suspension of operations, and the bank knew this. So I don't think the deposits were made in the ordinary course of business, but, if in due course, I think the bank knew of the practical impossibility of keeping it out of bankruptcy, which fact was well known to everybody. It seems to me, therefore, under the circumstances, that the trusteees are entitled to judgment, and I think interest should run from the time the referee declared the first dividend. A decree will be entered accordingly."

Here again we have a case where the facts are quite analogous. The deposits were made by the company itself, and not by a committee. The bankrupt's course of conduct contemplated a suspension of operations. In our case not only did the bank know of the "practical impossibility of keeping it [the company] out of bankruptcy," but intended that an assignment or bankruptcy should occur.

The foregoing are the controlling cases.

New York County National Bank v. *Massey*, 192 U.S. 138, is not an authority here in point. There it was not shown, as a fact, that the bank intended to apply the deposits until the application was actually made; hence it was held that the deposits were received in regular manner, and, therefore, permitted to be set off.

The case of *Studley* v. *Boylston Nat. Bank*, 229 U.S. 523, is without any authoritative application here, for the reason that knowledge of insolvency, or reasonable cause to believe a preference was being created, was not shown. Besides, the set-off in question constituted the charging up of a note,

which was a customary course of dealings between the parties. Nor is the recent case of *Citizens Nat. Bank* v. *Lineberger*, 45 F. (2d) 522 (4 C.C.A.), in point; for there the bank, after acquiring knowledge of insolvency, set off funds then in its possession against the debt due it.

We know of no more apt words for the characterization of the respondent's conduct than those employed by this court in the case of *May* v. *Henderson*, 268 U.S. 111, 119:

> "At most it was a clumsy, ineffectual and fraudulent effort to divert the funds of the bankrupt."

Conclusion.

The petitioner herein submits (*a*) that, as to the respondent's present contention that the Bankruptcy Court was without jurisdiction, notwithstanding its expressed consent given thereto, such contention is lacking both in legal and moral foundation; and (*b*) that, upon the facts of the case and the law applicable thereto, he is entitled to a judgment against the respondent in the sum of $20,476.79, with interest from the date of the filing of his original petition and with costs.

Respectfully submitted,

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